

1998 Comprehensive Annual Financial Report



California State Teachers'
Retirement System

A Component Unit of
the State of California

June 30, 1998



State Teachers' Retirement System

California State Teachers'
Retirement System
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California State Teachers' Retirement System
A Component Unit of the State of California
1998 Comprehensive Annual Financial Report for the year ended June 30, 1998

*Prepared by the staff of the California State Teachers' Retirement System
 7667 Folsom Boulevard Sacramento, CA 95826-2614*

James D. Mosman, Chief Executive Officer



Award GFOA Certificate

Certificate of Achievement for Excellence in Financial Reporting

Presented to

California State Teachers' Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1997

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Douglas R. Ellsworth
President

Jeffrey L. Esser
Executive Director

Award PPC Certificate



**Public Pension Coordinating Council
Public Pension Principles
1998 Achievement Award**

Presented to

California State Teachers' Retirement System

In recognition of instituting professional standards for public employee retirement systems as established by the Public Pension Principles.

Presented by the Public Pension Coordinating Council, a confederation of
Government Finance Officers Association (GFOA)
National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in black ink, appearing to read 'Scott Engmann', is written over a horizontal line.

Scott Engmann
Chairman



CEO Letter of Transmittal

December 20, 1998



California State Teachers' Retirement System
Post Office Box 15275
Sacramento, CA 95851-0275

I am pleased to present the Comprehensive Annual Financial Report of the California State Teachers' Retirement System for the fiscal year ended June 30, 1998. The report is intended to provide complete and reliable information as a basis for making management decisions, determining compliance with legal provisions, and determining responsible stewardship of the Teachers' Retirement Fund, Cash Balance Fund and CalSTRS 403(b) Program. Responsibility for both the accuracy and completeness of the financial data and the fairness of the presentation rests with me and the management of STRS.

I expect the Teachers' Retirement Board, California Legislature, and members of the system will find this CAFR helpful in understanding the California State Teachers' Retirement System, which was established by law in 1913 to provide retirement benefits to California's public school teachers. As of June 30, 1998, STRS members consisted of employees of approximately 1,157 contributing employers, including school districts, community college districts, county offices of education and regional occupational programs. (See page 98 for a list of employers.)

The 1998 CAFR consists of five sections:

The **introductory section** contains this letter of transmittal, the administrative organization, report of the Teachers' Retirement Board chairperson and a review of STRS achievements and activities.

The **financial section** includes the report of the independent auditor, the system's financial statements and supplemental information for the Teachers' Retirement Fund, Cash Balance Fund and CalSTRS 403(b) Program.

The **investment section** contains a consultant's report summarizing investment activity, an explanation of investment policy, portfolio

performance information and various investment schedules for the Teachers' Retirement Fund. Investment of the Cash Balance Fund is also discussed. Investment information is not included for the CalSTRS 403(b) Program since all investments are member-directed into mutual funds.

The **actuarial section** includes the actuary's certification letters and plan summaries for both the STRS Defined Benefit and Cash Balance plans, in addition to the results of the latest actuarial valuations.

The **statistical section** includes information on the STRS Defined Benefit Plan, Cash Balance Plan and CalSTRS 403(b) Program.

Accounting and Reporting

STRS accounting records are maintained on the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and state contributions are recognized when due and the employer or state has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the STRS retirement programs.

Sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements and supporting schedules.

Revenues

Actual member and employer contribution rates for both the Defined Benefit and Cash Balance plans are set by the Teachers' Retirement Law, a part of the Education Code, which assigns the authority to establish and amend contribution rates to the state Legislature.

Teachers' Retirement Fund Defined Benefit Plan contributions and investment income for fiscal year ended June 30, 1998, totaled \$16.629 billion.

Member	\$ 1.303 billion
Employer	\$ 1.371 billion
State	\$ 1.005 billion
Investment and other	\$12.950 billion



Cash Balance Fund contributions and investment income for fiscal year ended June 30, 1998, totaled \$1.649 million.

Participant	\$ 772,000
Employer	\$ 772,000
Investment and other	\$ 105,000

CalSTRS 403(b) Program

Participant contribution rates are set by the Internal Revenue Code. Contribution and investment income for fiscal year ended June 30, 1998, totaled \$7.990 million.

Participant	\$ 5.079 million
Investment	\$ 2.911 million

Expenses

Defined Benefit Plan

The Teachers' Retirement Fund was principally created to provide retirement, survivor, and disability benefits to eligible members and their beneficiaries. The total expenses for the year were \$3.209 billion, which included benefit payments, refund of contributions to terminated employees and the cost of administering the system. Administrative expenses are allocated through an annual budget approved by the Teachers' Retirement Board.

Cash Balance Plan

The Cash Balance Plan provides retirement, survivor and disability benefits to eligible participants. Total expenses for the year were \$466,000. The costs of the plan include administrative and interest expenses.

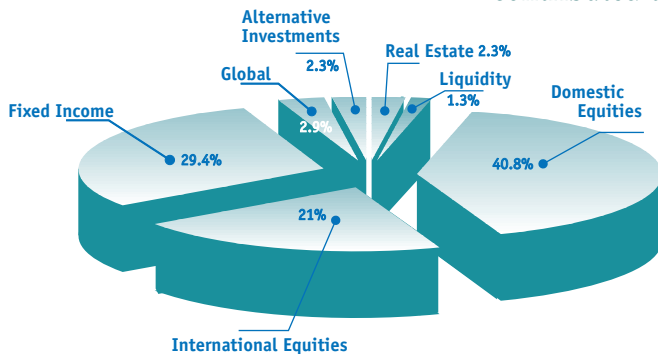
CalSTRS 403(b) Program

The CalSTRS 403(b) Program funds supplemental retirement benefits to eligible participants. Total expenses for the year were \$1.982 million, which includes recurring annuities, refunds and administrative expenses.

Investments

STRS is dedicated to obtaining the highest possible return on its investments of fund assets, given an acceptable level of risk. The STRS Investment Management Plan incorporates strategies that accomplish Teachers' Retirement Board direction. Reducing the system's funding costs, within prudent levels of risk, diversification, and reduction of

costs associated with managing the system assets are measures that have contributed to a solid investment portfolio.



As of June 30, 1998, the market value of the Teachers' Retirement Fund Investment Portfolio was \$88.3 billion, an increase of more than \$13 billion from the previous year. For fiscal year 1998, the annualized time-weighted return was 17.1 percent. The time-weighted returns were 15.9 percent for three years, 12.7 percent for five years, and 12.6 percent for ten years.

Funding

Progress toward a fully funded Defined Benefit Fund is positive, according to the most recent actuarial valuation (June 30, 1997). Under the provisions of the Elder Full Funding Act, STRS receives a state General Fund contribution set at 4.3 percent of prior calendar year member payroll. The 1997 actuarial valuation shows that the projected income stream to STRS will be sufficient to pay for projected benefits and past unfunded obligations over a period of approximately three years, an improvement from the 1995 valuation amortization period of 15 years. The actuarial accrued liability and actuarial value of assets of the system as of June 30, 1997, was \$69.852 billion and \$67.980 billion respectively. (See page 36 for a schedule of funding progress.)

Initiatives

STRS is in the final stages of establishing a new and more flexible database management system that will enhance service to members and support future STRS projects. Conversion to the new system is scheduled for March 2000.

STRS spent the 1997–98 fiscal year working toward completion of a project to ensure uninterrupted computer processing into the year 2000 and beyond. STRS updated its on-line computer system, which is used to establish and maintain active member accounts as well as pay benefits to Defined Benefit Plan members and beneficiaries. It also worked with other state agencies and member employers to guarantee their systems are compatible with STRS. The project was completed in November 1998.



Awards

The Government Finance Officers Association of the United States and Canada awarded a Certificate of Achievement for Excellence in Financial Reporting to the State Teachers' Retirement System for its comprehensive annual financial report for the year ended June 30, 1997. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

To be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. The State Teachers' Retirement System has received a Certificate of Achievement for the last two years. We believe our current report continues to meet the Certificate of Achievement Program requirements and are submitting it to GFOA for consideration again this year.

STRS was awarded the Public Pension Coordinating Council's Public Pension Principles Achievement Award in 1998. This two-year award is for achievement of high professional standards for public employee retirement systems. The award is based on compliance with principles that support retirement system achievements in the areas of benefits, actuarial valuations, financial reporting, investments and disclosures to members.

Acknowledgments

The compilation of this comprehensive annual financial report reflects the combined effort of STRS staff under the leadership of the Teachers' Retirement Board. I commend their efforts on creating another outstanding report. In addition, on behalf of the board, I take this opportunity to express my gratitude to the staff, advisors, and the many people who have worked so diligently to assure the successful operation of the California State Teachers' Retirement System.

Respectfully submitted,

James D. Mosman
Chief Executive Officer

Teachers' Retirement Board



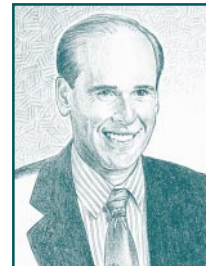
Emma Y. Zink,
Chairperson
(K-12 Classroom Teacher)
San Diego

Term:
November 6, 1991 to
November 7, 1995*



**Yvonne Gallegos
Bodle**
(Community College
Instructor)
Ventura

Term:
September 10, 1996 to
September 6, 2000



Gary Lynes
(K-12 Classroom Teacher)
Hillsborough

Term:
December 1994
to December 30, 1998



Lillian Raffel
Vice Chairperson
(School Board Member)
Beverly Hills

Term:
September 10, 1996 to
September 6, 2000



Delaine Eastin
Superintendent of
Public Instruction
Ex-Officio Member



Michael Mayer
(Banking Official)
Red Bluff

Term:
November 5, 1993
to November 14, 1998



Kathleen Connell
State Controller
Ex-Officio Member



Marty Mathiesen
(System Retiree)
Los Altos

Term:
June 4, 1996 to
June 16, 2000



Matthew Fong
State Treasurer
Ex-Officio Member



George W. Fenimore
(Public Representative)
Los Angeles

Term:
December 24, 1992 to
November 7, 2001



Craig L. Brown
State Director
of Finance
Ex-Officio Member

Vacant
(Insurance Official)

** Member continues to serve at
Governor's discretion.*



Executive Staff

as of June 30, 1998



James D. Mosman
Chief Executive Officer



Patrick Mitchell
Chief Investment
Officer



Peggy A. Plett
Deputy Chief
Executive Officer
Administration



**Jennifer
DuCray-Morrill**
Deputy Chief
Executive Officer
*Governmental Affairs
and Program
Development*



Kenneth L. Costa
Director
START Project



Christopher Waddell
Chief Counsel
Legal Office



Elleen Okada
Deputy Chief
Executive Officer
Investments



Michael J. Carter
Deputy Chief
Executive Officer
*Client Benefits
and Services*



Laurence P. Martin
Deputy Chief
Executive Officer
*Information and
Financial Systems*

Professional Services

STRS contracts for the services of various independent consultants essential to the effectiveness and professional operation of the system. Watson Wyatt Company provides actuarial services and the independent auditor is PricewaterhouseCoopers, LLP. Lists of investment professionals for investment services and other consultants are provided on schedules four and five in the financial section of the report. A brief list of independent consultants is shown below.

- PricewaterhouseCoopers, LLP
- Watson Wyatt Company
- Hogan and Hartson
- SPL Worldgroup Consulting
- Towers, Perrin, Forster
- William M. Mercer





Report of the Chair

On behalf of the Teachers' Retirement Board, I am pleased to present the California State Teachers' Retirement System 1998 Comprehensive Annual Financial Report. Nothing in the recent history of the system can compare with the achievements gained this year for those who look to STRS for service and retirement security.

The highlight of the year was the historic package of legislation that becomes effective January 1, 1999. The road to this unprecedented set of benefit enhancements began in March when an actuarial valuation revealed the Teachers' Retirement Fund was 97.3 percent funded.

Thanks to a higher investment rate of return than anticipated, the new valuation showed the current unfunded liability would be paid, or amortized, by 2000, instead of in 18 years, as shown in a 1995 valuation. With the Fund nearly funded, the time was right to work on enhancing the benefit structure.

To help in the deliberations by the Teachers Retirement Board, STRS conducted a study comparing the Defined Benefit Plan with the California Public Employees' Retirement System and the teachers' retirement systems in other states. The study showed the STRS benefits fell below the level of most of the other retirement systems. The study also showed STRS benefits did not meet the adequacy level desired by the Board.

To remedy this situation and fulfill long-held desires to improve benefits, STRS designed alternatives for consideration by the Legislature and Governor Wilson to provide an adequate retirement benefit and to provide teacher recruitment and retention incentives. These two objectives were met by the benefits package of legislation, crafted with input from teacher and employer groups.

The benefits package consisted of the Ralph Dills Teachers and Recruitment and Retention Act, Chapter 1006 (AB 1102—Knox); Chapter 966 (AB 1150—Prenter); Chapter 967 (AB 2804—Honda); and Chapter 968 (SB 1528—Schiff), all Statutes of 1998.

A coalition of interested parties educated legislators on the need to support the benefits package. The actual passage of the benefits package ended with a dramatic sprint to the finish line, with the Legislature voting on the bills during the last day of the two-year legislative session.

The final hurdle toward enactment was Governor Wilson's signature. The Governor, along with the Legislature, has long been interested in solving California's teacher shortage and recognized the recruitment and retention value of the benefits package. Even before the bills were passed, Governor Wilson had signaled his willingness to sign the legislation into law.

Any increase in benefits naturally comes with an increase in costs. TRB policy requires adequate funding as a prerequisite for new benefits. Therefore, one of the bills enacted in the benefits package establishes a payment plan for the unfunded obligations set up by the new benefits by refinancing the unfunded obligation remaining on the prior debt.

Rather than spending about \$650 million to reduce the prior debt by the year 2000, the General Fund will spend only about \$80 million a year over an extended period of time until the unfunded liability is eliminated. Most of the remaining money will pay the costs of the new benefits, with the remainder staying in the General Fund. In this way, the state spends less money than it otherwise would have and the teachers of California get needed and well-deserved retirement benefits.

Respectfully submitted,



Emma Y. Zink
Teachers' Retirement Board, Chairperson